STATE OF UTAH INSURANCE DEPARTMENT

REPORT OF FINANCIAL EXAMINATION

of

AMERICAN LIBERTY INSURANCE COMPANY.
of

Provo, Utah

as of

December 31, 2006

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October 24, 2007

Honorable D. Kent Michie, Commissioner
State of Utah Insurance Department
3110 State Office Building
Salt Lake City, UT 84114

Commissioner:

Pursuant to your instructions and in compliance with statutory requirements, an examination, as of December 31, 2006, has been made of the financial condition and business affairs of:

American Liberty Insurance Company.
Provo, Utah

hereinafter referred to in this report as the Company, and the following report of examination is respectfully submitted.

SCOPE OF EXAMINATION

Period Covered by Examination

The current examination covers the period from the inception of the Company, October 26, 2004, through December 31, 2006, including any material transactions and/or events occurring subsequent to the examination date noted during the course of the examination.

Examination Procedure Employed

The examination included a general review and analysis of the Company's operations, the manner in which its business was conducted, and a determination of its financial condition as of December 31, 2006. The examination was conducted in accordance with generally accepted standards and procedures of regulatory authorities relating to such examinations.

This examination was conducted under the association plan of the National Association of Insurance Commissioners (NAIC) in accordance with the Financial Condition Examiners Handbook. It also incorporated risk-focused examination techniques.

The initial phase of the examination focused on evaluating the Company's governance and control environment, as well as business approach, in order to develop an examination plan tailored to the Company's individual operating profile. A functional activity approach was determined to be appropriate. The following functional areas were selected for examination: Management, Investment, Premium, Losses & Benefits, Operations, Financial Reporting, and Reinsurance.

The examination determined the inherent risks associated with each of the functional areas and assessed the residual risk for each of the areas after considering the mitigating factors. Mitigating factors considered were corporate governance and control environment in addition to work performed by external audit functions. Interviews were held with the senior management of the Company to gain an understanding of the entity's operating profile and control environment. Based on the assessment of residual risk examination procedures were reduced where considered appropriate.

A letter of representation attesting to the Company's ownership of all assets and to the nonexistence of unrecorded liabilities was signed by and received from the Company's management.

An independent certified public accounting (CPA) firm was retained to audit the Company's financial records for the years ended 2005 and 2006. Audit reports generated by the firm were made available for the examination's review. Audit working papers were made available to the examination and utilized for examination purposes when deemed appropriate.

HISTORY

General

The Company was organized and incorporated under the laws of the state of Utah on May 5, 2004 as a stock corporation, and was licensed as a property and casualty insurer authorized to write workers compensation insurance on October 26, 2004.

During the examination period the Company's Articles of Incorporation were restated as amended as follows:

- The number of shares authorized was changed from 1,000,000 common stock shares to 20,000,000 common stock shares and 5,000,000 preferred stock shares.
- The corporate initial registered office was changed to its current address, 3601 North University Ave., Suite 100, Provo, UT 84604, and the initial registered agent was changed from Randall Smart to Truman Child.
- The number of separate natural persons specified to hold the corporate offices of Chief Executive Officer, President, Secretary and Treasurer was changed from three persons to two persons.

Capital Stock

The Articles of Amendment to the Articles of Incorporation, dated February 6, 2006, authorize the Company to issue 20,000,000 shares of $.001 par value common stock and 5,000,000 shares of preferred stock. There were 9,430,000 shares of common stock and 570,000 shares of preferred stock issued and outstanding. Truman Child, holding 66.30% of the issued common stock, is the ultimate controlling person. No other person holds more than 6.25% of the issued common stock.

Dividends to Stockholders

The Company paid no dividends to stockholders during the examination period.

Management

The following persons served as directors of the Company as of December 31, 2006:

Name	Principal Occupation
Truman Boyce Child Lindon, Utah	Chief Executive Officer, Treasurer American Liberty Insurance Company
Gregory Brian Moessing Franklin, Massachusetts	Managing Director Cambridge Associates LLC
Gary Douglas Smith Sandy, Utah	President Zerorez Franchising Systems

The officers of the Company as of December 31, 2006, were as follows:

Principal Officer	Office
Truman Boyce Child	Chief Executive Officer, Treasurer
Stephen Beryle Greenfield	President
Richard Troy Worthington	Secretary

The members of the Principal Committees as of December 31, 2006, were as follows:

Audit Committee	Investment Committee
Truman Boyce Child	Truman Boyce Child
Gary Douglas Smith	Gregory Brian Moessing

Conflict of Interest Procedure

The Company did not have a conflict of interest policy as of December 31, 2006. During the examination the Company initiated such a policy and all directors and principal officers signed conflict of interest forms.

The conflict of interest forms disclosed the following relationships:

- Truman Child disclosed his controlling equity interest in American Liberty Holdings, Alpine Insurance Agency, and Pay America. Each of these entities has contractual agreements with the Company.

- Troy Worthington disclosed a minority equity interest in American Liberty Holdings, Alpine Insurance Agency, and Pay America. Each of these entities has contractual agreements with the Company.

Corporate Records

A review of the minutes of the meetings of the shareholders and board of directors document adequate approval and support of Company actions. Minutes were not kept for meetings of the investment, auditing, and compensation committees.

The examination could not objectively determine that the investment committee had reviewed investment practices or ensured investment practices were in compliance with applicable law, or that the audit committee had maintained an overview of the activities of the Outside Auditors in order to advise the Board on the adequacy of fiscal control.

Acquisitions, Mergers, Disposals, Dissolutions, and Purchases or Sales through Reinsurance

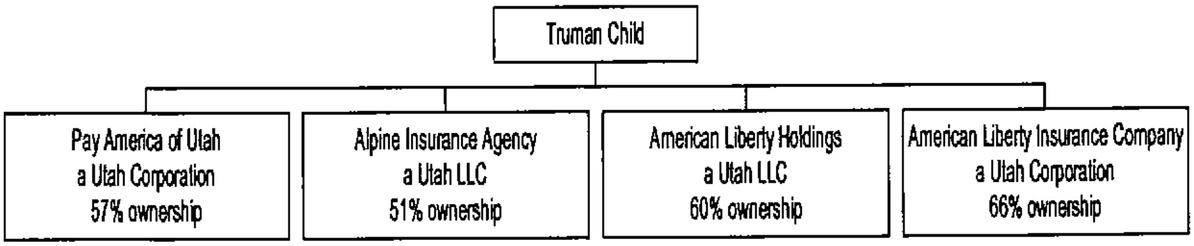
There were no acquisitions, mergers, disposals, dissolutions and purchases or sales through reinsurance that involved the Company during the examination period.

Surplus Debentures

No surplus debentures were issued or retired during the examination period and none were outstanding as of December 31, 2006.

AFFILIATED COMPANIES

The Company and related parties are ultimately controlled by Truman Child. The following organizational chart illustrates the holding company structure as of December 31, 2006:



The Company did not file a Form B Holding Company registration with the Commissioner pursuant to the requirements of Utah Code Annotated (U.C.A.) § 31A-16-105(1).

Transactions with Affiliates

The Company has an agreement with Pay America for professional employer services. Pay America provides, as employer, leased employees to the Company. Pay America performs the following services: pays the leased employees wages including employment taxes; applicable state unemployment insurance; manages unemployment claims; and maintains contact with the leased employees for addressing staff complaints. Service fees paid in 2006 amounted to $14,886.

The Company has an agreement with American Liberty Holdings to provide services for a Manager (Truman Child). The Manager assumes the operational and managerial responsibility of certain operations of the Company, including but not limited to promotion and advertising of the Company. The Manager performs his duties and responsibilities as assigned by the Board of Directors. Management fees paid to in 2006 were $130,672.

The Company has a producer agreement with Alpine Insurance Agency (Alpine). Alpine agrees to receive and transmit to the Company account applications for workers compensation insurance and to collect and receive premium on behalf of the Company. Alpine receives a commission on the premium for these services, which was $61,792 in 2006.

The Company did not notify the Commissioner in writing, at least 30 days prior, of its intention to enter into these service and management agreements with Pay America, American Liberty Holdings, and Alpine Insurance Agency pursuant to the requirement of U.C.A. § 31A-16-106(1)(b)iv.

FIDELITY BOND AND OTHER INSURANCE

The minimum fidelity coverage suggested by the NAIC for an insurer of the Company's size and premium volume is not less than \$125,000. As of the examination date, the Company maintained fidelity bond coverage of \$110,000. The Company also had additional insurance protection for general liability.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

Company staff is employed by Pay America, a related company. Wages and benefits are not provided by the Company and the financial statement does not include obligations for such plans.

STATUTORY DEPOSITS

As of December 31, 2006, the Company's statutory deposit requirement was \$300,000 pursuant to U.C.A. § 31A-5-211(2)(b)(vii) as referenced by U.C.A. § 31A-4-105. The Company maintained a statutory deposit consisting of two Federal Home Loan Bank bonds and cash with an aggregate market value of \$304,230 and an aggregate par value of \$300,000.

INSURANCE PRODUCTS AND RELATED PRACTICES

Policy Forms and Underwriting

The Company adopted the National Council on Compensation Insurance (NCCI) forms for use in its policy contract and endorsement forms. The Company filed and used these forms as modified with its company identification added. As of December 31, 2006, the Company's risk retention was \$750,000.

Territory and Plan of Operation

The Company is only authorized to transact workers compensation insurance in Utah.

The Company markets its products through payroll companies, professional employer organizations, independent and agency insurance producers, and direct sales. The Company maintains small sales and telemarketing departments and has appointed two individuals and twenty-five agency insurance producers.

Advertising and Sales Material

The Company does only a modest amount of advertising. This advertising consists of web based content, brochures, flyers, and radio. The purpose of the advertising is to enhance Company name recognition, and to promote policy related service, savings, security and automated payment availability.

Treatment of Policyholders

During the examination period there were no instances of policyholder complaints filed with the Department. The Company maintained control over policyholder complaints throughout the examination period. Written procedures to handle written complaints were in place.

Unresolved employee/claimant complaints are referred, as prescribed by U.C.A § 34A-2-801, for adjudication and administrative action hearings within the Division of Adjudication, a division of the Labor Commission. The Company did not have any such complaints. Company procedures and minimal complaints indicated that the Company maintained control over policyholder complaints.

REINSURANCE

As of December 31, 2006, the Company ceded premium for two layers of excess of loss reinsurance coverage.

The first layer of reinsurance was through an agreement with Midwest Employers Casualty Company (MECC), and it provided coverage for eligible claims in excess of $750,000 not to exceed $5,000,000.

The second layer of reinsurance was through an agreement with Max Re, which provided coverage for eligible claims in excess of $5,000,000 not to exceed $10,000,000. Max Re is not an authorized insurer in Utah pursuant to U.C.A § 31A-17-404, therefore the Company was disqualified from taking credit for reinsurance related to the agreement unless the reinsurer provided a security factor such as an irrevocable and unconditional letter of credit. Article XXV of the agreement entitled "Security for Unauthorized Reinsurance," contained a provision for providing such a letter of credit, but a letter of credit was not obtained by the Company.

The examination verified that there were no claims in excess of the $750,000. Neither the first or second layer of reinsurance was penetrated. Because no claims exceeded the Company's retention level, the examination concluded that all reinsurance credit could reasonably be allocated to the first authorized level of reinsurance. Therefore, no adjustment to Losses and Surplus for reinsurance credit was necessary.

Subsequent to the examination date the Company replaced both prior agreements with a single excess of loss agreement with MECC, an authorized insurer, providing the Company for payment of eligible claims in excess of $500,000 not to exceed $10,000,000.

ACCOUNTS AND RECORDS

The Company utilizes a centralized computer record processing system, supplemented by ancillary records maintained either manually or on personal computers. A trial balance, as of December 31, 2006, was prepared from the Company's general ledger. Account balances were traced to annual statement reports, exhibits, and schedules without material exception. Individual account balances were examined as deemed necessary.

Deficiencies encountered by the examination relating to accounts and records include:

1. As of December 31, 2006, the Company did not hold its security investments under a custodial agreement or trust arrangement pursuant to U.C.A. § 31A-4-108 that complied with Utah Administrative Code (U.C.A.) Rule R590-178. During the examination, on April 25, 2007, the Company entered into a custodial agreement with Zions First National Bank, the holder of its statutory deposit. On July 2, 2007, it entered into a custodial agreement with Charles Schwab & Company (Schwab), covering all remaining invested securities, The Board of Directors approved both agreements on July 25, 2007.

   On September 6, 2007 the Company revised its agreement with Schwab to use the term "agent", as defined by U.A.C. R590-178-3, in lieu of the undefined term "subcustodian". The Board of Directors approved the revision on October 26, 2007.

2. The Company reported an NAIC 1Z designation for numerous investments in Schedule D. Pursuant to the Purposes and Procedures Manual of the NAIC Securities Valuation Office (SVO) Part Three Section 4, Z designated securities must be submitted to the SVO for valuation within 120 days of the date the security was acquired. The Company did not submit the investments to the SVO for valuation.

   The examination determined that eight of these securities were U.S. government bonds that should been designated as filing exempt (FE). The remaining securities were federally insured (FDIC) certificates of deposit.

FINANCIAL STATEMENTS

The following financial statements were prepared from the Company's accounting records and the valuations and determination made during the examination:

BALANCE SHEET as of December 31, 2006

STATEMENT OF INCOME for the Year Ended December 31, 2006

RECONCILIATION OF CAPITAL AND SURPLUS – 2004 through 2006

The accompanying NOTES TO FINANCIAL STATEMENT is an integral part of the financial statements.

AMERICAN LIBERTY INSURANCE COMPANY
BALANCE SHEET
as of December 31, 2006

		Net Admitted Assets	
Bonds	$	2,289,785	(1)
Mortgage loans on real estate		140,000	(2)
Cash and short-term investments		1,628,666	(1)(3)(5)
Investment income due and accrued		33,672	
Uncollected premium		359,767	
Reinsurance: Other amounts receivable		136,410	
Aggregate write-ins for other than invested assets:			
Recoverable on claim payments advanced		0	(4)
Aggregate write-ins for other than invested assets:			
Miscellaneous receivable		2,771	
Total assets	$	4,591,071	

LIABILITIES, SURPLUS AND OTHER FUNDS

Losses	$	1,798,147	(4)
Loss adjustment expenses		266,861	
Other expenses		163,092	
Taxes, licenses and fees		146,932	
Advance Premium		312,928	
Amounts withheld or retained for the account of others		76,817	
Payable for securities		150,000	(5)
Total liabilities		2,914,777	
Common capital stock		2,500	
Preferred capital stock		10,000	
Gross paid in and contributed surplus		1,959,911	
Unassigned funds (surplus)		(296,117)	(2)
Total capital and surplus		1,676,294	
Total liabilities, capital and surplus	$	4,591,071	

AMERICAN LIBERTY INSURANCE COMPANY
STATEMENT OF INCOME
for the Year Ended December 31, 2006

		Amount
UNDERWRITING INCOME		
Premiums earned	$	4,950,243
DEDUCTIONS:		
Lossess incurred		2,303,492
Loss expenses incurred		339,789
Other underwriting expenses incurred		2,080,477
Total underwriting deductions		4,723,758
Net wnderwriting gain (loss)		226,485
INVESTMENT INCOME		
Net investment income earned		126,231
Net investment gain (loss)		126,231
Net income before federal income taxes		352,716
Federal income taxes incurred		183,149
Net income		169,567

AMERICAN LIBERTY INSURANCE COMPANY.
RECONCILIATION OF CAPITAL AND SURPLUS
2004 through 2006

	2004	2005	Per Exam 2006	Notes
Surplus as regards policyholders, prior year	$ (0)	$ 1,517,528	$ 1,529,845	
Net income or (loss)	(9,883)	(31,756)	169,567	
Change in nonadmitted assets		(150,928)	(281,618)	(2)
Capital changes:				
Paid in	12,500			
Surplus adjustments:				
Paid in	1,514,911	195,000	250,000	
Aggregate write-ins:				
Prior year audit adjustments			8,499	
Rounding		1	1	
Net change in capital and surplus	1,517,528	12,317	146,449	
Surplus as regards policyholders, end of reporting year	$ 1,517,528	$ 1,529,845	$ 1,676,294	

NOTES TO FINANCIAL STATEMENT

(1) <u>Bonds</u> <u>$ 2,289,785</u>

The Company reported bonds in the amount of $3,689,778. The examination determined that according to the NAIC Annual Statement Instructions, fourteen of the certificates of deposit reported as long term certificates on Schedule D, have less than one year between acquisition and maturity, and should be treated as cash. Bonds were reduced by $1,399,993 with a concurrent increase in cash.

(2) <u>Mortgage loans on real estate: First liens</u> <u>$ 140,000</u>

The Company reported a Mortgage loan asset of $450,000. The asset consisted of two mortgage loans identified as loan numbers 1 and 103 on schedule B Part 1 of the annual statement and valued at $150,000 and $300,000 respectively.

The examination reviewed loan number 1 for evidence of over-encumbrance and found the loan slightly over-encumbered, greater than 80% of the appraised value, pursuant to U.C.A §31A-18-106(2)(b). The examination reduced the mortgage loan asset by $10,000.

Loan number 103 was significantly over-encumbered, for which the Company was unable to provide evidence to the contrary. The examination non-admitted the asset and reduced the mortgage loans by $300,000.

(3) <u>Cash</u> <u>$1,628,666</u>

The Company reported a Cash asset of $78,673. Concurrent with the decrease of the bond asset for the reclassification of fourteen certificates of deposit, the cash asset was increased by $1,399,993.

The examination determined that included in the cash asset was a negative $150,000 for a security purchase transaction at year end, which should have been reported as a payable for securities liability pursuant to the NAIC Annual Statement Instructions for Liabilities, Surplus and Other Funds. The examination increased the cash by $150,000 and increased the Payable for securities liability by the same amount.

(4) <u>Aggregate write-in for other than invested assets: Recoverable on claim payments advanced</u> <u>$ 0</u>

<u>Losses</u> <u>$ 1,798,147</u>

The Company reported an aggregate write-in asset for a recoverable on claim payments advanced of $309,100. Subrogation recoverables should be deducted from the liability for losses pursuant to the Accounting Practices and Procedures Manual, SSAP

55. The examination reclassified the aggregate write-in asset of $309,100 and reported it as Losses.

(5) Payable for securities $ 150,000

The Company did not report a Payable for securities liability. The examination determined that securities which were purchased at the 2006 year end, and not paid for, should have been reported as a payable for securities liability. A reclassification from cash in the amount of $150,000 was made.

CAPITAL AND SURPLUS

The Company's capital and surplus was determined to be $310,000 less than reported in its annual statement as of December 31, 2006. The following schedule identifies the examination changes to specific balance sheet lines:

Description	Statement Dr (Cr)	Per Examination	Surplus Inc. (Dec.)	Notes
Bonds	$ 3,689,778	$ 2,289,785	$ (1,399,993)	(1)
Mortage loans: First Lien	450,000	140,000	(310,000)	(2)
Cash	78,673	1,628,666	1,549,993	(1)(3)(5)
Aggregate write-ins: Recoverable on claim payments advanced	309,100	0	(309,100)	(4)
Losses	(2,107,247)	(1,798,147)	309,100	(4)
Payable for securities	0	(150,000)	(150,000)	(5)
Total examination changes			(310,000)	
Surplus as regards policyholders per Organization			1,986,294	
Surplus as regards policyholders per Examination			$ 1,676,294	

The Company's minimum capital requirement was $300,000 as specified in U.C.A. § 31A-5-211(2)(b)(vii). As of December 31, 2006, the Company reported total adjusted capital of $1,986,294, a company action level of $1,741,745, and its authorized control level risk based capital requirement of $870,723.

Examination adjustments reduced total adjusted capital to $1,676,294, company action level to $1,740,649, and the authorized control level risk based capital requirement to $870,324. As adjusted, the total adjusted capital was below the company action level with a 1.93 RBC ratio. RBC ratios in the first and second quarters of 2007, accounting for examination adjustments, are above the company action level at 2.00 and 2.38 respectively.

SUMMARY OF EXAMINATION FINDINGS

The following is a summary of examination findings and significant information:

1. The Company did not have a conflict of interest policy as of December 31, 2006. During the examination the Company initiated such a policy and all directors and principal officers completed conflict of interest forms. (HISTORY – Conflict of Interest Procedure)

2. The Company did not register file a Form B Holding Company registration statement with the Commissioner pursuant to the requirements of U.C.A § 31A-16-105(1). (AFFILIATED COMPANIES)

3. The Company had a second layer reinsurance agreement with an insurer that was not authorized in the state of Utah. Credit for reinsurance related to the agreements with unauthorized reinsurers, pursuant to U.C.A § 31A-17-404, is only allowed when the reinsurer provides a security factor such as an irrevocable and unconditional letter of credit. Because no claims exceeded the Company's retention level, the examination concluded that all reinsurance credit could reasonably be allocated to the first authorized level of reinsurance. Therefore, no adjustment to Losses and Surplus for reinsurance credit was necessary. Subsequent to the examination date the Company replaced the second layer agreement with one from an authorized insurer. (REINSURANCE)

4. As of December 31, 2006, the Company did not hold its security investments under a custodial agreement or trust arrangement pursuant to U.C.A. § 31A-4-108 that complied with U.C.A. Rule R590-178. During the examination, on April 25, 2007, the Company entered into a custodial agreement with Zions First National Bank, the holder of its statutory deposit, On July 2, 2007, it entered into a custodial agreement with Charles Schwab & Company which covered all remaining invested securities. The Board of Directors approved both agreements on July 25, 2007.

On September 6, 2007 the Company amended its agreement with Schwab to use the term "agent", as defined by U.A.C. R590-178-3, in lieu of the undefined term "subcustodian". The Board of Directors approved the amendment on October 26, 2007. (ACCOUNTS AND RECORDS)

5. One mortgage loan was significantly over-encumbered, pursuant to U.C.A §31A-18-106(2)(b). The examination non admitted the asset reducing surplus by $300,000. A second mortgage loan exceeded 80% of the appraised value, which does not comply with U.C.A §31A-18-106(2)(b). This asset was reduced by $10,000. (NOTES TO FINANCIAL STATEMENT – (2) Mortgage loans on real estate: First liens)

6. The Company's minimum capital requirement was $300,000 as specified in U.C.A. § 31A-5-211(2)(b)(vii). As of December 31, 2006, the Company reported total adjusted capital of $1,986,294, a company action level of $1,741,745, and its authorized control level risk based capital requirement of $870,723.

   Examination adjustments reduced total adjusted capital to $1,676,294, company action level to $1,740,649, and the authorized control level risk based capital requirement to $870,324. As adjusted, the total adjusted capital was below the company action level with a 1.93 RBC ratio. RBC ratios in the first and second quarters of 2007, accounting for examination adjustments, are above the company action level at 2.00 and 2.38 respectively. (CAPITAL AND SURPLUS)

ACKNOWLEDGEMENT

The courteous and responsive cooperation extended by employees of the Company is acknowledged and appreciated. Malis Rasmussen, Financial Examiner participated in the examination. Colette M. Hogan, CFE, Assistant Chief Examiner, supervised the examination.

Respectfully Submitted,

Donald Catmull, CFE
Examiner-In-Charge
Utah Insurance Department